

PERFORMANCE AUDIT
OF THE
OFFICE OF PURCHASING
DEPARTMENT OF MANAGEMENT AND BUDGET
December 1997

EXECUTIVE DIGEST

OFFICE OF PURCHASING

INTRODUCTION	This report, issued in December 1997, contains the results of our performance audit* of the Office of Purchasing (OOP), Department of Management and Budget (DMB).
AUDIT PURPOSE	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.
BACKGROUND	OOP is responsible for the procurement of supplies, materials, services, equipment, and printing used by the operating agencies. OOP's mission* is to establish and operate an efficient and effective procurement system that takes into account quality, prices paid, the cost of the procurement transaction, and timeliness. OOP had 34 employees as of May 31, 1996.
AUDIT OBJECTIVES, CONCLUSIONS, AND NOTEWORTHY ACCOMPLISHMENTS	<p>Audit Objective: To determine whether OOP established measurable goals* and objectives* and accumulated data related to those goals and objectives, and whether it is attaining those objectives.</p> <p>Conclusion: OOP established goals and objectives; however, it has limited ability to measure the attainment of those goals and objectives. Thus, it was not possible to determine whether OOP was attaining those goals and</p>

* See glossary on page 20 for definition.

objectives. Our assessment disclosed one reportable condition*. The purchasing management information system does not provide sufficient management information regarding work load, timeliness, and noncompliance with established procedures (Finding 1).

Audit Objective: To assess the effectiveness of OOP's internal control structure* for the purchasing process.

Conclusion: We concluded that the internal control structure over the purchasing process was generally effective. However, our assessment disclosed two reportable conditions related to monitoring compliance with purchasing policies and procedures (Finding 2) and monitoring of operating agencies (Finding 3).

Noteworthy Accomplishments: OOP had implemented three new purchasing programs which should substantially reduce purchasing and payment processing costs, and goods or services should be received in a more timely manner. The three programs are the Procurement Card, Quick Purchase, and Just-in-Time Programs.

Audit Objective: To assess OOP's compliance with laws, policies, and procedures in the purchasing process.

Conclusion: We did not note any noncompliance with laws related to purchasing. However, we concluded that there was noncompliance with established purchasing policies and procedures (Finding 2).

Audit Objective: To evaluate OOP's handling of

* See glossary on page 20 for definition.

complaints and the use of vendor performance information in the purchasing process.

Conclusion: OOP management cannot determine the extent of complaints and whether they were resolved in a timely manner. Also, buyers do not have the benefit of a vendor performance record to assist them in the purchasing process. Our evaluation disclosed one reportable condition related to complaints and taking vendor performance into account when making purchasing decisions (Finding 4).

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Office of Purchasing. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit methodology included evaluating controls that management has established for the purchasing programs; examining a sample of transactions to determine compliance with laws, policies, and procedures; examining a sample of complaints; reviewing the use of vendor historical performance data in the purchasing process; and assessing objectives, measuring techniques, and data related to objectives. Our audit included examinations of OOP's records and activities for the period October 1, 1993 through August 31, 1996.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report includes 4 findings and 5 corresponding recommendations. DMB's preliminary response indicated it had complied with all the recommendations.
DMB complied with 4 of 5 prior audit recommendations.

One of the prior audit recommendations was no longer applicable.

Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Murray:

This is our report on the performance audit of the Office of Purchasing, Department of Management and Budget.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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OFFICE OF PURCHASING DEPARTMENT OF MANAGEMENT AND BUDGET

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Description of Agency

Section 18.1261 of the *Michigan Compiled Laws* (a section of the Management and Budget Act) states that the Department of Management and Budget (DMB) shall provide for the procurement of supplies, materials, services, equipment, and printing needed by State agencies. The Office of Purchasing (OOP) is the organizational unit within DMB which administers these statutory duties. OOP's mission is to establish and operate an efficient and effective procurement system that takes into account quality, prices paid, the cost of the procurement transaction, and timeliness.

OOP is organized into seven buying units and a support services section. OOP had 34 employees as of June 30, 1996; this is down from 46 employees as of our prior audit in 1990.

During 1996, OOP instituted three new purchasing programs designed to streamline the purchasing process and improve its timeliness. The three programs are the Procurement Card, Quick Purchase, and Just-in-Time Programs.

The Procurement Card Program uses credit cards issued to individuals performing purchasing functions in the various agencies. This Program is intended to streamline the purchasing process and reduce the administrative cost of making small purchases. The cards can be used for purchases up to \$1,000 for most items not on a State contract. Credit limits are assigned and the operating agencies can, and do, restrict the type of vendor that the card can be used at. The operating agencies specify the credit limit and any vendor restrictions when they enroll an employee into the Program.

As of May 17, 1996, there were 329 active cards and \$265,473 was charged to them for the two-week period that ended on that date. This Program began in June 1995 and is being gradually phased in. Twelve of eighteen departments had enrolled in the Program as of May 17, 1996.

The Quick Purchase Program is similar to the regular purchasing program but with less formality. Rather than obtaining formal competitive bids, the quick purchases may be made on the basis of telephone quotes, fax bids, or price proposals received by the operating agencies. The operating departments also get to specify a preferred provider.

The OOP buyers are free to use their discretion as to whether other quotes or bids should be requested. Each buyer relies on similar purchases at other agencies, catalogs, bulletin boards, and the buyer's knowledge of the market. The buyer has the discretion to consider sources other than those suggested by an agency but must discuss the reasons for the departure with agency personnel. This program applies to most one-time purchases of \$1,000 to \$25,000.

OOP policies require agencies to be enrolled in the Procurement Card Program in order to participate in the Quick Purchase Program. The Quick Purchase Program began December 18, 1995 and all agencies began participation by September 30, 1996. This Program was designed to reduce the cost of issuing a purchase order and to speed up the purchasing process. These purchases are expected to take 10 days or less, and the OOP buyer is required to review the requisition within 5 working days. This is quicker than the regular purchasing process.

The Just-in-Time Program replaces the Paper and Stationary Stores Program ran by DMB. Rather than stock office supply items using numerous vendors, one vendor supplies all office supplies. The contract with this vendor provides for delivery within 24 to 48 hours depending on the agencies' locations. OOP has projected that this Program will result in annual savings of \$1.5 million. This Program began on May 15, 1996 and is being phased in.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit of the Office of Purchasing (OOP), Department of Management and Budget (DMB), had the following objectives:

1. To determine whether OOP established measurable goals and objectives and accumulated data related to those goals and objectives, and whether it is attaining those objectives.
2. To assess the effectiveness of OOP's internal control structure for the purchasing process.
3. To assess OOP's compliance with laws, policies, and procedures in the purchasing process.
4. To evaluate OOP's handling of complaints and the use of vendor performance information in the purchasing process.

Audit Scope

Our audit scope was to examine the program and other records of the Office of Purchasing. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures were conducted during the months of July through September 1996 and included examinations of OOP's records and activities covering the period October 1, 1993 through August 31, 1996.

To accomplish our objectives, we:

1. Assessed OOP's objectives, measuring techniques, and data related to objectives. We also determined whether objectives were sufficient for program management to evaluate the programs.
2. Evaluated controls that management had established to ensure that the purchasing programs meet their goals, comply with laws and regulations, and safeguard resources.
3. Examined a sample of transactions to determine if laws, policies, and procedures were complied with for each of the various purchasing programs.
4. Examined a sample of complaints to determine whether they were adequately resolved. Also, we reviewed the use of vendor historical performance data in the purchasing process.
5. Compared purchasing methods used with widely accepted methods recognized as contributing to effective purchasing.

Agency Responses and Prior Audit Follow-Up

Our audit report includes 4 findings and 5 corresponding recommendations. DMB's preliminary response indicated it has complied with all the recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require DMB to develop a formal response to our audit findings and recommendations within 60 days after the release of the audit report.

DMB complied with 4 of 5 prior audit recommendations. One of the prior audit recommendations was no longer applicable.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

GOALS AND OBJECTIVES

COMMENT

Background: The Advanced Purchasing and Inventory System* (ADPICS), a new purchasing information system, was implemented on October 1, 1994 as part of the Michigan Administrative Information Network (MAIN). This information system is the basic source of management information relating to the purchasing process.

Audit Objective: To determine whether the Office of Purchasing (OOP) established measurable goals and objectives and accumulated data related to those goals and objectives, and whether it is attaining those objectives.

Conclusion: OOP established goals and objectives; however, it has limited ability to measure the attainment of those goals and objectives. Thus, it was not possible to determine whether OOP was attaining those goals and objectives. Our assessment disclosed one reportable condition. The purchasing system, ADPICS, does not provide sufficient management information regarding work load, timeliness, or noncompliance with established procedures.

FINDING

1. Management Information System

ADPICS does not provide several types of information that would be effective tools for OOP management. The information that ADPICS does not provide include:

- a. Work load data by individual buyer or division.
- b. Purchase order timeliness summary information.
- c. Identification of purchases that were not processed within established time frames.

* See glossary on page 20 for definition.

- d. Summary or detailed information regarding the amount or number of sole source purchases.

Work load data could serve as a basis for establishing staffing levels within the various buyer groups within OOP.

Improving the timeliness of the purchasing process is one of the basic objectives of OOP. Without a method to measure timeliness, it is not possible to determine whether timeliness is being improved or in need of further improvement.

Also, ADPICS does not identify or differentiate between regular purchases and quick purchases. For quick purchases, the operating agencies perform most of the purchasing functions. They identify suppliers, obtain quotes, and pick a suggested supplier. The OOP buyers involved in quick purchases review the work that the operating agencies have performed and normally issue the purchase orders. The OOP buyers request quotes only when they are not satisfied that the suggested supplier's price is reasonable. There are also different timeliness deadlines for quick purchases. Thus, work load or timeliness analysis should consider regular purchases and quick purchases separately.

Without access to these types of information, it is much more difficult for OOP management to evaluate performance.

During our audit, OOP and the Department of Management and Budget (DMB) were developing new ADPICS features to provide work load data in a wide variety of formats. These features became operational in October 1996.

RECOMMENDATION

We recommend that DMB develop additional reports, accessible through ADPICS, to provide management information related to work load, timeliness, and the extent of sole source purchases.

AGENCY PRELIMINARY RESPONSE

DMB informed us that it complied with this recommendation. DMB was successful in working with MAIN and MAIN Management Information Data Base staff to

develop reports and on-line inquiries which meet the recommended goals of providing information related to work load, timeliness, and sole source purchases.

INTERNAL CONTROLS

COMMENT

Audit Objective: To assess the effectiveness of OOP's internal control structure for the purchasing process.

Conclusion: We concluded that the internal control structure over the purchasing process was generally effective. Our assessment disclosed two reportable conditions. OOP does not have a system for monitoring compliance with purchasing policies and procedures and does not monitor operating department compliance with purchasing policies and procedures.

FINDING

2. Control System and Written Policies and Procedures

OOP does not have a system for monitoring compliance with purchasing policies and procedures. Also, written purchasing policies and procedures have not been revised to reflect significant changes in purchasing philosophy and practices.

Our review of 101 purchase orders (PO's) for compliance with established policies and procedures disclosed:

- a. Six PO's did not have the required sealed bids. Sealed bids are required if the estimated cost of a PO is above certain dollar values.
- b. Three operating agencies conducted the bidding for three PO's with estimated costs over \$2,500 when procedures called for OOP to conduct the bidding. The amounts of these PO's ranged from \$19,000 to \$46,000. DMB Administrative Guide procedure 510.03 requires OOP to obtain bids from vendors if the estimated cost of the PO is over \$2,500. OOP did review the bids that the operating agencies obtained.

- c. Three PO's were increased in amount without evidence of proper approval. OOP policy requires different management levels to approve increases in PO's based on the amount of the increases.
- d. Three PO's were processed without OOP receiving approval from the requesting agency for bids that were greater than 110% of the estimated cost as required by DMB Administrative Guide procedure 510.02.
- e. Seven PO's were dated after the contract period began. Determining that a PO is issued before work is begun is primarily the operating agency's responsibility. OOP should revise contract period beginning dates to correspond with the PO starting date in these instances.

Purchasing procedures were included in the DMB Administrative Guide distributed in January 1994. Since that time, there have been significant changes in purchasing philosophy and practices. Procedures have not been revised to reflect this change in philosophy and current practices. These procedures and OOP internal operating procedures were developed to ensure that prudent purchasing practices are followed on a Statewide basis. OOP informed us that revised purchasing policies and procedures manuals have been prepared.

Our review also disclosed that clarification is needed for documentation requirements for the approval of purchases. OOP policy requires different management level approvals depending on the amount of the PO. How this approval is supposed to be documented is not specified.

We also noted instances of vendors being allowed to fax bids in lieu of requiring sealed bids. Current policies and procedures do not include provisions for the use of this method. Procedures should be developed to specify when the acceptance of faxed bids is appropriate and how these bids are to be processed to protect the integrity of the bid process.

RECOMMENDATIONS

We recommend that OOP develop a system for monitoring compliance with its policies and procedures.

We also recommend that OOP revise purchasing policies and procedures to reflect changes in philosophy and practices.

AGENCY PRELIMINARY RESPONSE

OOP informed us that it has complied with the first recommendation. Prior to the implementation of MAIN in October 1994, OOP was developing a desk manual for staff use. Because of the many changes in internal processes, terminology, and workflow dictated by the MAIN system, this effort was suspended while staff became acclimated to the new procedures.

OOP also informed us that it has complied with the second recommendation. OOP revised DMB Administrative Guide policy 0510 on purchasing and this policy was issued to all agencies on March 21, 1997.

FINDING

3. Monitoring of Operating Departments

DMB has not established a monitoring system to assess and enforce operating agencies' compliance with purchasing policies and procedures. DMB has established purchasing policies and procedures in its Administrative Guide. However, DMB has not monitored compliance with these policies and procedures.

The operating agencies had issued \$71.1 million of blanket purchase orders* (BPO's) for the period October 1, 1994 through May 31, 1996. We reviewed purchase orders for 555 commodities/service types totaling \$69.5 million. Our review of these purchase orders disclosed that 12% of them exceeded the delegated limit as defined in the DMB Administrative Guide. Basically, all BPO's valued at \$10,000 or above must be processed by OOP unless the commodity is specifically exempted or the Quick Purchase Program is used. OOP approval is required for Quick Purchase Program purchase orders. OOP approval is not required for BPO's within the operating agencies' delegated limits.

* See glossary on page 20 for definition

Section 18.1261 of the *Michigan Compiled Laws* assigns DMB the responsibility for purchasing contractual services, supplies, and materials needed by State

agencies. This law also authorizes DMB to delegate purchasing authority to the operating agencies. This law further states that DMB may withdraw delegated purchasing authority if agencies do not comply with purchasing policies and procedures.

DMB remains responsible for purchasing activities delegated to the operating agencies. Thus, DMB should be monitoring the purchasing activities of the operating agencies for compliance with its policies and procedures. Because OOP has not monitored the procurement activities of the operating agencies, agencies that have not complied with purchasing policies and procedures have not had their delegated purchasing authority reduced or withdrawn.

RECOMMENDATION

We recommend that DMB establish a monitoring system to assess and enforce operating agency compliance with purchasing procedures.

AGENCY PRELIMINARY RESPONSE

DMB informed us that it complied with this recommendation. Effective October 1, 1997, new policies and procedures were developed jointly by OOP, DMB's Office of Financial Management, and the Department of Civil Service to enable monitoring of contract usage, sole source awards, use of direct vouchers, and agency established contracts.

COMPLIANCE WITH LAWS, POLICIES, AND PROCEDURES

COMMENT

Audit Objective: To assess OOP's compliance with laws, policies, and procedures in the purchasing process.

Conclusion: We did not note any noncompliance with laws related to purchasing. However, we concluded that there was noncompliance with purchasing policies and procedures (see Finding 2 under our second audit objective).

COMPLAINTS

COMMENT

Audit Objective: To evaluate OOP's handling of complaints and the use of vendor performance information in the purchasing process.

Conclusion: OOP management cannot determine the extent of complaints and whether they were resolved in a timely manner. Also, buyers do not have the benefit of a vendor performance record to assist them in the purchasing process. Our evaluation disclosed one reportable condition related to complaints and taking vendor performance into account when making purchasing decisions.

FINDING

4. Complaints and Vendor Performance

OOP did not have a system for recording the receipt of vendor complaints or for taking vendor performance into account when making purchasing decisions.

OOP was unable to provide us with a record of complaints received. When OOP receives complaints from the operating agencies they are referred to the buyers who processed the purchase orders for follow-up. Once a complaint is resolved or the necessary action is taken, OOP files the complaint with the related purchase order. A log of complaints received is not maintained. Thus, it is not possible to determine how many complaints were received or which vendors they related to.

Prior to ADPICS, copies of complaints were included in vendor files maintained for establishing bidders lists and a record of complaints received was included on the automated purchasing system. However, with ADPICS, another unit within DMB

controls access to the bidders lists and the decision was made to file complaints with the applicable purchase order. With this prior system, it was possible to review a specific vendor's file to determine whether a large number of complaints or serious complaints were lodged against the vendor.

Provisions were not made on ADPICS for accumulating data on vendor performance.

Without complaint or performance information being included on ADPICS or filed in some other manner, buyers do not have a readily accessible source of information regarding vendor performance. Vendor performance should be taken into account when making purchasing decisions.

RECOMMENDATION

We recommend that OOP establish a system for recording the receipt of vendor complaints and taking vendor performance into account when making purchasing decisions.

AGENCY PRELIMINARY RESPONSE

OOP informed us that it complied with this recommendation. Vendor performance through ADPICS was activated on June 1, 1997. This functionality allows reporting of negative and positive performance, tracking these records through resolution, and compiling this data to assist with vendor assessment.

Glossary of Acronyms and Terms

Advanced Purchasing and Inventory Control System (ADPICS)	The software system used by the State to process purchasing transactions.
blanket purchase order (BPO)	A purchase order that is open for an extended period of time and normally has periodic orders and payments.
DMB	Department of Management and Budget.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
goals	The agency's intended outcomes or impacts for a program to accomplish its mission.
internal control structure	The management control environment, management information system, and control policies and procedures established by management to provide reasonable assurance that goals are met; that resources are used in compliance with laws and regulations; and that valid and reliable performance related information is obtained and reported.
MAIN	Michigan Administrative Information Network.
mission	The agency's main purpose or the reason the agency was established.

objectives	Specific outputs a program seeks to perform and/or inputs a program seeks to apply in its efforts to achieve its goals.
OOP	Office of Purchasing.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
PO	purchase order.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.